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Testifying in support of SB 906: AN ACT CONCERNING NON-COMPETES

Senator Kushner, Representative Porter, Senator Sampson, Representative Arora and members of the Labor & Public Employees Committee:

Thank you for the opportunity to testify in support of SB 906, An Act Concerning Non-Competes. This bill is well supported by research and would align Connecticut with a national movement to regulate these agreements.

Noncompetes have a harmful effect on job mobility, wages, competition, entrepreneurship, and equality. They restrict employees from switching employers or starting their own competing business. Those restrictions depress wages, reduce entrepreneurship, and impede efforts to correct inequities. In the past decade, a wealth of research—empirical, experimental, and theoretical studies—offers evidence about the key role that human capital policy, including noncompete contracts, plays in industries and regions. Research on the question of labor market mobility has taken multiple forms: longitudinal studies, comparative regional studies, patent network mapping, surveys, behavioral lab experiments, ethnographies, simulations, and modeling. As a 2018 article states, "policymakers, economists, and legal scholars . . . overwhelmingly conclude that the harms of noncompetes far outweigh their potential benefits."[1] Evidence comes from shifts in state policy, including changes in Michigan (1980), Vermont (2005), Oregon (2008), South Carolina (2010), Georgia (2010), and Hawaii (2015). Studies also examine enforcement differences between states that do enforce noncompetes and those that don't, finding that weaker enforcement of noncompetes correlates with increased job mobility. In both the longitudinal and comparative regional studies, the findings show that job mobility is good for wages, industry and regional economic growth, and equality.

Entrepreneurship. Noncompetes favor large incumbent firms. Studies find that markets become more concentrated when noncompetes are adopted and enforced. When employees sign non-competes, start-ups companies face difficulties recruiting talent. When California banned noncompetes, it generated greater and faster innovation because employees with good ideas that their employer did not want to use were able to take the idea elsewhere.

A policy that prohibits noncompetes solves a collective action problem. Mobility benefits innovative and growing firms, which need to hire new workers, but without a mobility policy, firms will attempt to prevent their employees from moving to competitors.

Wages. Noncompetes decrease wages. Employers set compensation largely based on competing external offers. When external offers are reduced, employers face less pressure to increase wages. Even without noncompetes, the nature of job search and the inherently burdensome switching costs for employees create job markets where employers have too much power. In 2016, the Council of Economic Advisors concluded that "employers may be better able to exercise monopsony power today than they were in past decade," which can "undermine competition, tend to reduce efficiency, and can lead to lower output, employment, and social welfare." In 2015, Hawaii passed a law banning noncompete and non-solicitation clauses from employment contracts in the high tech industry. A new study finds that the Hawaii ban

[1] Rebecca Morrow, "Noncompetes as Tax Evasion," *Washington University Law Review* 96, no. 2 (2018).

increased employee mobility in the sector by 11% and increased new-hire salaries by 4%.[2] Other studies demonstrate that noncompetes reduce wages even for employees who have not signed them. A 2017 study looking at how noncompetes affect monopsony power via employee mobility and across 30 states finds that higher enforceability of post-employment restrictions is associated with longer jobless spells and a greater chance of employees leaving the state. Importantly, the study also finds persistent wage-suppressing effects that last throughout a worker's job and employment history. The researchers conclude that noncompetes lower worker welfare, reduce employees' bargaining power relative to the firm, and lock them into their jobs, reduces the elasticity of labor supply, and dampens labor market dynamism, further reducing both wage competition and mobility.

Equality. Restrictions on job mobility have a disproportionate negative effect on certain demographics. In job markets, discovering one is competitive depends on the frequency with which one is exposed to information about one's comparative options in the market. In job markets that have infrequent bargains, the "price" of labor—that is, the terms and conditions of an employee's contract—will lag behind the employee's true market value. When an employee receives an external offer from a competitor employer, the employee uses that information to negotiate a higher salary with his current employer. If his current employer offers to match the higher salary to retain his services, the competitor employer can come back with an even higher job offer: "Workers bound by non-competes cannot rely on outside offers and free market competition to fairly value their talents. Without incentives to increase wages in-house, companies can allow salaries to plateau."[3]

Noncompetes harm equality in several ways. First, on average, women are more likely to have geographic constraints based on family and spousal obligations. Under such circumstances, a noncompete that restricts an employee's ability to compete within a region will likely mean a professional detour, a forced sabbatical out of the labor market, or staying longer with an employer rather than relocating to a new city. Second, women and minorities are more likely to have non-monetary preferences for a workplace that is free of discrimination and hostility and that values diversity. For example, if a woman discovers that her employer systematically allows harassment of its female employees, she will have a strong interest in examining other opportunities in the market. But a noncompete restricting her mobility will prevent her from escaping the discriminatory workplace. Third, without the opportunity to receive outside offers, historical pay gaps will persist or even widen with internal raises. Employees do not have full information about other job opportunities and cannot discover their true value without external offers. Noncompetes make it harder to get those offers, and therefore make it disproportionately harder for women and minorities who are historically underpaid to correct that.

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There is growing momentum at the state and federal levels to restrict noncompetes. In October 2016, the White House issued a Call for Action urging states to limit the use of post-employment restrictions. Also in 2016, the U.S. Treasury Department issued a report on noncompetes warning that, when noncompetes are enforced, "innovations spread more slowly, possibly inhibiting the development of industrial clusters like Silicon Valley." In 2020, the Federal Trade Commission convened a meeting to consider promulgating a rule to prohibit noncompete clauses.

In 2018 and 2019, Massachusetts, Washington, Maryland, and New Hampshire each passed a new law voiding most noncompetes. Several federal bills have also been drafted that would limit the use of

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[2] Natarajan Balasubramanian et al., "Locked In? The Enforceability of Covenants Not to Compete and the Careers of High-Tech Workers" (U.S. Census Bureau Ctr. for Econ. Studies, Working Paper No. CES-WP-17-09, Ross Sch. of Bus., Working Paper No. 1339, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2905782.

[3] Orly Lobel, "Companies Compete But Won't Let Their Workers Do the Same," *New York Times*, May 4, 2017, https://www.nytimes.com/2017/05/04/opinion/noncompete-agreements-workers.html.

noncompetes, either entirely or for low-wage workers. And the evidence shows that states that ban noncompetes innovate faster and entice workers away from those that don't.

The modern economy depends on employee mobility. Our workforce needs to be able to respond to sudden disruptions like COVID-19, which radically shifted the demand for workers, and to longer term geographic and economic trends. And employees should have the freedom to take the job that is best for them, or to start a new company if they have an innovative new idea that otherwise will never see the light of day.

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Evan Starr, "Consider This: Training, Wages, and the Enforceability of Covenants Not to Compete," *ILR Review: The Journal of Work and Policy* 72, no. 4 (2019): 783 (finding "an increase from non-enforcement to mean enforceability is associated with a 4% decrease in hourly wages" even in lower skilled jobs).